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Defense White Paper Urges Continued Vigilance

Although the Cold War era has come to a close, the Japan Defense Agency's 1991 white paper urged a continuation of current military spending levels and the maintenance of a close defense relationship with the United States. The white paper, released July 26, omitted for the second year in a row a decade-old reference to the "latent Soviet threat" to regional security. The agency noted, however, that continued vigilance is warranted because Moscow has made qualitative improvements to its Asian Pacific weaponry. Evidence also suggests that North Korea may be developing a nuclear capability, the white paper warned, a situation that potentially could destabilize the region. Perhaps most significant, JDA for the first time called on the Japanese public to consider what roles the Self-Defense Forces might play internationally, such as participating in United Nations-sponsored peacekeeping efforts. Until recently SDF's military mission was limited strictly to an area within 1,000 nautical miles of the home islands due to the government's long-held interpretation of the war-renouncing clause of Japan's "peace constitution."

The white paper acknowledged that the Soviet Union now is in a difficult position to stage aggressive action against other countries because of its domestic economic and political problems as well as the loss of a support network when its former satellites in Eastern Europe embraced political and economic reforms. But the situation in the Asian Pacific region is "more complicated"

Tokyo already has initiated such an exchange under the auspices of the Japan International Cooperation Agency, which is responsible for coordinating Japan's public-sector technical assistance program. Later this month a JICA team is scheduled to visit Romania to identify areas where help would be beneficial, such as the environment and social infrastructure. Also at the end of August the first of a group of about 20 Romanians will arrive in Japan for technical training.

Mr. Nakayama's promises of additional technical assistance were seconded by Minister of International Trade and Industry Eiichi Nakao. The MITI official promised that Romanians would be included in training programs for Eastern Europeans conducted by Japanese companies in Europe and that later this year Japanese experts would be sent to Romania to help improve that country's productivity.

The Japanese government has been cautious about extending aid to Eastern Europe. The promising prospects of further assistance for Romania are tempered by Tokyo's announcement this spring that it planned to freeze new loans to Poland. The move to hold off on new commitments to Warsaw was in response to the decision of the so-called Paris Club of creditor countries to forgive half of Poland's government-to-government debt and reflected Tokyo's hopes of dissuading other debtor nations from requesting similar relief. Ministry of Finance officials, in particular, have expressed their dissatisfaction with debt forgiveness, which they feel engenders irresponsible attitudes toward repaying loans.

Margo Grimm

Japan's Current Account Surplus Jumps

First, the bad news for those concerned about Japan's large external payments imbalances with its trading partners. The surplus registered by the broadest measure of Japan's trade -- the current account -- jumped 136.6 percent in the second quarter of 1991 compared to a year earlier (see Table 1). Second, the good news: the same statistic. While the surging current account surplus reflected an increase in net exports of goods and services, it also meant that the long-dreaded slowdown in Japanese funds flowing overseas remains more threat than reality despite the ongoing problems in the Japanese stock market and economy.

The ballooning of Japan's current account surplus in the second quarter resulted from two major factors. First, its trade surplus grew significantly, a phenomenon reflected in the customs-clearance trade figures released earlier this summer (see JEI Report No. 28B, July 26, 1991). To a substantial extent the larger surplus reflects the year-to-year change in the yen's value against the dollar. In the April-June period compared to 1990's second quarter the yen strengthened substantially, lifting the dollar value -- although not the volume -- of exports. As long as the yen-dollar exchange rate maintains its mid-August range of Y135 to Y140=$1.00 the rise in the trade surplus initially will diminish then reverse over time as the stronger yen reduces exports and lifts imports. Second, the April-June services imbalance reflected the lingering effects of the Persian Gulf War; net travel payments dropped significantly in April and May compared to a year earlier but rebounded in June to their approximate 1990 level. Taken together, these two factors suggest that future

Table 1: Japan's Balance of Payments

(in millions of dollars)

	Trade Balance	Exports (f.o.b.)	Imports (f.o.b.)	Services (net)	Current Account Balance	Long-Term Capital (net)
1986	$92,827	$205,591	$112,764	$-4,932	$85,845	$-131,461
1987	96,386	224,605	128,219	-5,702	87,015	-136,532
1988	95,012	259,765	164,753	-11,263	79,631	-130,930
1989	76,917	269,570	192,653	-15,526	57,157	-89,246
1990	63,528	280,374	216,846	-22,292	35,761	-43,586
1989: I	21,311	66,945	45,634	-3,595	16,064	-5,612
II	19,794	66,560	46,766	-4,892	14,283	-30,801
III	19,770	68,157	48,387	-4,023	14,957	-21,559
IV	16,042	67,908	51,866	-3,016	11,853	-31,274
1990: I	14,393	65,460	51,067	-701	12,305	-16,086
II	13,614	65,510	51,896	-5,279	7,892	-18,985
III	17,149	70,500	53,351	-8,045	7,400	-7,247
IV	18,372	78,904	60,532	-8,267	8,164	-1,268
1991: I	20,729	74,978	54,249	-920	10,260	10,707
II(p)	22,994	71,943	48,949	-3,708	18,671	-6,931

quarters are not likely to reveal comparable year-to-year jumps in Japan's current account surplus.

In addition, the April-June figures suffered in comparison with the first-quarter data for a special reason. Japan's large contribution to the multinational effort in the Persian Gulf distorted the January-March data; without this special influence the first-quarter current account surplus would have been larger than the second-quarter one, other factors equal.

The larger current account surplus has had implications for Japan's outbound capital flow, to which it is conceptually equal. Table 2 shows Japan's international long-term securities transactions, one important element of short- and long-term capital flows. Since 1987 Japan's declining current account surplus has coincided with a drop in the net outflow of funds from Japan for the purchase of long-term securities. One factor since late last year has been renewed foreign interest in the Japanese stock market, peaking at $17.5 billion in net purchases in the first quarter of this year. In the last quarter of 1990 and the first quarter of 1991, the overall figure for foreign purchases in Japan exceeded Japanese purchases abroad, but a strong recovery of overseas Japanese stock and bond activity reversed the situation during the second quarter.

While the jump in the current account surplus in the second quarter reflected a series of one-time events, few analysts expect that the surplus will decline significantly in coming quarters. Most recent estimates put the 1991 surplus at between $41 and $45 billion, values that may be somewhat too low in

Table 2: Japan's Net International Long-Term Securities Transactions

(in millions of dollars)

	Net Japanese Purchases			Net Foreign Purchases			Net
	Bonds	Stocks	Other*	Bonds	Stocks	Other**	Outflow
1986	$-93,024	$-7,048	$-1,905	$-2,109	$-15,758	$18,412	$-101,432
1987	-72,885	-16,874	2,002	6,675	-42,835	30,079	-93,838
1988	-85,812	-2,993	1,856	-21,628	6,810	35,116	-66,651
1989	-94,083	-17,887	-1,208	2,400	6,998	75,746	-28,034
1990	-28,961	-6,256	-4,464	16,991	-13,276	30,938	-5,028
1989: I	-14,003	104	577	-1,646	9,004	16,212	10,248
II	-25,091	-6,108	-776	-587	-6,196	27,501	-11,257
III	-25,871	-4,795	722	5,403	757	14,123	-9,661
IV	-29,118	-7,088	-1,731	-770	3,433	17,910	-17,364
1990: I	-869	-4,946	717	6,182	-11,713	8,246	-2,383
II	-9,353	-2,153	-954	4,975	838	723	-5,924
III	-10,905	-459	-2,405	4,790	-3,380	10,485	-1,874
IV	-7,834	1,302	-1,822	1,044	979	11,484	5,153
1991: I	-13,356	463	-1,348	1,418	17,486	9,129	13,792
II(p)	-22,423	-2,840	-1,353	6,348	4,140	11,831	-4,297

*Yen-denominated bonds issued in Japan.
**Bonds issued outside of Japan by Japanese institutions.

Note: For outflows, a minus (-) sign indicates an increase in assets abroad. For inflows, a positive value indicates an increase in Japanese liabilities to foreigners.

light of the latest figures. Almost certainly Japan's current account surplus will be higher than 1990's, which was the lowest figure since 1984. Whether Americans regard that prospect as good or bad depends in part on whether they put more emphasis on a continued supply of foreign capital or reductions in Japan's imbalance in trade of goods and services.

Douglas Ostrom

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The views expressed in this report are those of the authors and do not necessarily represent those of the Japan Economic Institute.

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